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E.O. 12958: N/A
TAGS: ECON EFIN EPET PGOV EG
SUBJECT: GOE RAISES FUEL PRICES TO OFFSET SALARY INCREASE

Ref: Cairo 930

SUMMARY

¶1. (SBU) Parliament passed a series of revenue generating measures to offset the cost to the budget of the 30% wage increase announced by President Mubarak on April 30 (reftel). The measures include fuel and cigarette price increases, higher automobile registration fees, and imposition of some new taxes. The measures met with considerable opposition both in parliament - with all independents and members of the Muslim Brotherhood bloc voting against the changes and several ruling party members not supporting the measures - and among the Egyptian public. Many contacts believe the move essentially cancels the positive effect of the salary increase. Economic analysts are also concerned that the measures, especially fuel prices increases, will exacerbate inflation. From a fiscal viewpoint, the new revenue will help ensure that the deficit does not worsen, but politically, this step may make it more difficult for the GOE to make structural changes to the subsidy system. End summary.

PARLIAMENT PASSES NEW REVENUE MEASURES

¶2. (U) On May 5, Egypt's parliament approved several new revenue measures to offset the cost of the 30% public sector salary increase (approximately LE 4.86 billion, or $916 million) announced by President Mubarak on April 30 (reftel). Mubarak had ordered the government to ensure that the salary increase was "budget-neutral." The Ministry of Finance (MOF) had already submitted the FY 2008/09 budget to parliament before Mubarak announced the salary increase, thus necessitating additional revenue-generating measures to ensure the projected deficit of 6.9% did not worsen. While the new measures may prevent the deficit from worsening, they are unlikely to help the GOE reach its stated goal of reducing the deficit to 4% by FY 2010/11. Inflation is also likely to increase as the new measures, especially a decrease in the fuel subsidy, take effect. Inflation continued to climb in April, reaching 16.4%, up from 14.4% in March. Analysts expect inflation to reach 20% in May, when the fuel price increases register on the CPI.

ANATOMY OF THE NEW MEASURES

¶3. (U) The new revenue measures include (NOTE: All revenues estimates are taken from media reports):

-- An increase in the price of 90, 92 and 95-octane gasoline, diesel

(gas oil), and kerosene by 35%, 32%, 57%, 47%, and 47% respectively. The new price for a liter of each of these fuels is now LE 1.75 ($.33), LE 1.85 ($.34), LE 2.75 ($.51), LE 1.1 ($.20) and LE 1.1 ($.20) per liter, respectively. These measures are expected to reduce the GOE fuel subsidy bill by LE 5.94 billion ($1.11 billion), bringing to it to an estimated LE 52.06 billion ($9.73 billion) for FY 2008/09.

-- A 10% increase in sales tax on locally-made cigarettes and 33% percent on imported cigarettes. This is expected to raise LE 1.3 billion ($243 million) in additional revenues.

-- A 20% tax on interest earned on treasury bills.

-- Private schools and universities will lose their tax exemptions, raising an estimated LE 100 million ($18.8 million) in May-June ¶2008.

-- Prices of natural gas used by energy-intensive industries, including steel, fertilizer and petrochemicals, will increase 58% from LE .36 ($.06)/cubic meter to LE .57($.10)/cubic meter, generating an estimated LE 1.6 billion ($299 million) in revenue.

-- Energy-intensive industries operating in industrial free zones will also be subject to increased registration fees, equivalent to LE 600 million ($112 million) in revenues.

-- Quarried clay, used in the manufacture of cement, will be subject to a new LE 35($6.5)/metric ton tax, expected to bring in LE 1 billion ($187 million) in revenue.

-- New annual registration fees for private vehicles. Registration fees on vehicles are not high in nominal terms, but will increase significantly on a progressive basis determined by engine size. The GOE expects this measure to earn about LE 1.1 billion ($205 million) annually.

UPSET REACTION

¶4. (SBU) Debate was heated in parliament before the measures passed by 297 votes. The National Democratic Party (NDP) MPs largely (but not unanimously) supported the changes and all opposition parliamentarians (including the 87-member bloc of Muslim Brotherhood (MB) MPs) voted against them. The opposition accused the government of conspiring to undermine the impact of the wage increase. One opposition MP told emboff that the regime proved through this move that it enjoys "a great deal of stupidity and foolishness." The government argued on the parliamentary floor and in coordinated appearances by senior ruling party officials and ministers on evening TV talk shows, that the changes were necessary to prevent the wage increase from exacerbating inflation. The MB posted a statement on its website opposing the fuel price increases, and called on the government instead to "restore the country's stolen wealth from business tycoons and punish the corrupt." The MB roundly blames the government for the current economic difficulties faced by the poor and middle class and predicted that higher fuel prices will further deteriorate most Egyptians' standard of living.

¶5. (SBU) We polled several Egyptian contacts on their reaction to the price increases. Some said that the government should have raised passage fees on the Suez Canal or the price of controversial natural gas exports to Israel instead of burdening the already-suffering Egyptian population. Other contacts argued that the president and his government have made those who refused to take part in the recent May 4 general strike "feel like real fools," adding that "the government would have sufficient funds for everything if it simply cut ministers' expenses and the Ministry of Interior's legions of Central Security Forces, which beat Egyptian demonstrators." Many sought comfort in saying that "the president cannot live much longer and this could be the beginning of a big wake-up in Egypt." Others derided the government and NDP policies, saying that "they will ultimately bring the president down." Separately, gas station workers, who do not receive salaries and rely on tips instead, said they will be hard-hit by the increase in fuel prices because customers will stop tipping.

¶6. (U) Despite these comments, the immediate impact of the price hikes has been minimal, with no major demonstrations or violence. However, press reports claim that fistfights, like those seen in bread lines recently, have been breaking out around Cairo during rush hour as minibus drivers dispute prices with passengers. Cairo's privately-run minibuses, which service low-income earners, have increased their prices as of May 7 by as much as 50%. For intercity travel, for example, the price of a ticket to go from Shobra (in Cairo) to the delta city of Mehalla has gone from LE 7 ($1.32) to LE 8 ($1.50). Within Cairo, the price has gone from 30 ($.05) to 50 piasters ($.10). For already squeezed lower-income Egyptians, such price increases are difficult to bear. There are unconfirmed reports that in the wake of the price increases, thousands of plain-clothes policemen were deployed throughout Cairo "just in case."

COMMENT

¶7. (SBU) Analysts had been concerned that the 30% salary increase, coupled with additional spending on subsidies, would set the GOE's deficit reduction goal back by several years. From a purely fiscal standpoint, the government's new measures help address these concerns. The larger-than-expected increase in salaries may have caught the MOF somewhat off guard, as the new revenue-raising measures are a mixed bag of ideas MOF had on hold pending the need to generate additional revenue and hastily conceived ideas that are not yet fully developed. The energy increases, for example, are the third in a series since 2004 and are part of a longer-term subsidy reduction plan previously articulated by the government. Elimination of the exemption for energy-intensive industries operating in the free zone, however, lacks some clarity. Tax exempt status is an important part of being a "free zone," so it remains to be seen how the move will impact business.

¶8. (SBU) Some measures may have unintended positive effects. The tax free status of t-bill earnings has until now been a major factor in the reluctance of Egyptian banks to identify new customers and expand their lending. The measure could act as an incentive to encourage banks to more aggressively seek profits through lending and through expanding their loan portfolios, providing more credit to the economy. Banks have had the luxury of not pursuing new customers, given the favorable rates on t-bills, combined with their tax free status. As the measure will not apply to bonds, and the government is trying to expand the bond market, the measure could also spur development of longer term debt instruments, which the Egyptian economy needs.

¶9. (SBU) From a political standpoint, the skeptical Egyptian public views the 30% salary raise, closely followed by the gas and cigarette price increases, as President Mubarak "giving with one hand, and taking away with the other." The price increases feed into already simmering public resentment about inflation in general. In the current economic environment, we do not believe the government will undertake major structural reform of the subsidy program, though it will continue to chip away at the fuel subsidy. Even with the current price increase for gas, however, Egypt still has some of the most regressive energy pricing in the world. Equally unlikely is the prospect that the government will tackle the other major fiscal drain, the bloated civil service.
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